Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Dutton	Analyst:	Norman Catelli	Bill Number:	AB 1270
Related Bills:	See Legislative History	Telephone:	845-5117	Introduced Date:	February 21, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Manufacturers' Investment Credit/Extend to Electric Power Generation

SUMMARY

This bill would extend the Manufacturers' Investment Credit (MIC) to activities related to electric services (power generation, transmission, or distribution).

This analysis addresses only those provisions of the bill affecting the Franchise Tax Board (FTB).

PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to increase the incentive for the production of electricity in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and by the specific terms of the bill, would be operative for taxable years beginning on or after January 1, 2004.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's trade or business and allow a depreciation deduction for the obsolescence or wear and tear of property used in a trade or business or for the production of income.

Existing federal law does not have a credit comparable to the MIC.

Existing state law allows qualified taxpayers a credit equal to 6% of the amount paid or incurred after January 1, 1994, for qualified property that is placed in service in California.

Board Position:			Department Director	Date
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For purposes of the MIC, a qualified taxpayer is any taxpayer engaged in manufacturing activities described in specified codes listed in the Standard Industrial Classification (SIC) Manual, 1987 edition. Qualified property is any of the following:

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code (IRC), used in a qualified SIC Code activity, and used primarily for:

- manufacturing, processing, refining, fabricating, or recycling of property;
- research and development;
- the maintenance, repair, measurement, or testing of otherwise qualified property; or
- pollution control that meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) For certain taxpayers engaged in specified SIC Code activities, special purpose buildings and foundations.

For taxpayers engaged in computer programming and computer software related activities, qualified property includes computers and computer peripheral equipment used primarily for the development and manufacture of prepackaged software, and the value of any capitalized labor costs directly allocable to such property.

The MIC explicitly excludes certain types of property from the definition of qualified property, such as furniture, inventory, and equipment used in an extraction process.

The MIC sunsets on January 1st of 2001 or the earliest subsequent year if the Employment Development Department determines that manufacturing (excluding aerospace) employment in California on the preceding January 1st does not exceed the January 1, 1994, employment level by at least 100,000 jobs. Based on the Governor’s Budget (2003-2004) economic forecast, decreases in manufacturing employment are expected to cause the MIC to sunset on January 1, 2004.

THIS BILL

This bill extends the MIC to those activities related to electric services (power generation, transmission, or distribution) described in the SIC Manual Code 4911. This bill adds taxpayers engaged in activities related to electric services to the narrow list of taxpayers eligible to claim the MIC for special purpose buildings and foundations. The bill also makes minor non-substantive changes to the existing statute.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department’s programs and operations.

TECHNICAL CONSIDERATIONS

To achieve the author's goal, the definition of "qualified cost" should be amended to limit the credit to costs paid or incurred on or after January 1, 2004. The Governor's Budget anticipates decreases in manufacturing employment to cause the MIC to sunset on January 1, 2004. The author might consider an amendment to extend the sunset date. Department staff is available to assist the author with these amendments.

The attached Amendments 1 through 4 would reference the specific laws that changed the MIC.

LEGISLATIVE HISTORY

SB 2X (Poochigian, 2003-2004) and SB 47 (Ackerman, 2003-2004) would remove the repeal date from the MIC, effectively extending the credit indefinitely. SB 2X and SB 47 are in the Senate Revenue and Taxation Committee.

SB 137 (Morrow, 2003-2004) would remove the repeal date from the MIC, effectively extending the credit indefinitely. SB 137 also would raise the MIC rate from 6% to 8%. SB 137 is in the Senate Revenue and Taxation Committee.

AB 122 (Calderon, 2003-2004) would extend the credit until at least January 1, 2006. AB 122 is scheduled to be heard in the Assembly Revenue and Taxation Committee on April 7, 2004.

AB 1276 (Campbell, 2001-2002) would have extended the MIC to electric power generation businesses. AB 1276 was held in the Assembly Revenue and Taxation Committee.

AB 473 (Hertzberg, 1999-2000) would have extended the repeal date to January 1, 2004. AB 473 was held in the Senate Appropriations Committee.

SB 2145 (Knight; 1999-2000) would have removed the repeal date from the MIC, extending the credit indefinitely. SB 2145 was held in the Senate Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. Special emphasis was placed on identifying benefits related to electric power generation:

New York provides an investment tax credit (ITC) to manufacturers for certain depreciable equipment or buildings. The credit is 5% of up to $350 million of qualified expenditures and 4% for qualified expenditures in excess of $350 million. Certified pollution control, industrial waste treatment, and acid rain control facilities also qualify for this credit. Research and development (R&D) property may qualify for an optional rate of 9%.

Illinois provides a replacement tax investment credit equal to 0.5% of the basis of qualified property used by a taxpayer primarily engaged in manufacturing, retailing, coal mining, or fluorite mining.

Massachusetts provides a 3% credit based on the cost of qualified property used for manufacturing, farming, fishing, or research and development.

Michigan provides a graduated investment tax credit based on adjusted gross receipts of a firm. The credit is a percentage (0.85% to 2.3%) of the net costs of qualifying tangible, depreciable assets located in Michigan.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

The following revenue impact assumes that the MIC would continue under current law. However, if decreases in manufacturing employment cause the MIC to sunset, then the provisions of this bill would become inoperative and there would be no revenue impact:

Revenue Impact of AB1270 For Taxable Years Beginning on or After 1/1/2004 Assumed Enactment After 6/30/2003 Fiscal Years (In Millions)		
2003-4	**2004-5**	**2005-6**
-$15	-$65	-$115

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

<u>Revenue Discussion</u>

The revenue effect of the MIC credit is generally determined by the following formula:

"Qualified costs" incurred in "qualifying activities" by a "qualified taxpayer" multiplied by 6% equals the gross amount of the MIC credit earned.

The amount of MIC credit allowed to reduce tax liability is limited by the amount of alternative minimum tax, if any, for the year. Other tax rules require a carryover credit to be applied to the limitation amount until exhausted. The newly-earned credit may be applied to any remaining tax liability balance. The amount of the newly-earned credit actually applied to tax liability is the revenue impact. Any credit not applied to the current year tax liability is a carryover to the next year.

This bill would expand the MIC to taxpayers engaged in activities described in SIC Code 4911. The revenue effect of this bill was determined by applying the above methodology to a forecast of qualifying costs, qualifying activities, and qualified taxpayers related to SIC Code 4911. This forecast was based on available U.S. Census information identifying capital expenditures by businesses classified in North American Industry Classification System (NAICS) Code 2211, which is a successor to SIC Code 4911.

There is an unidentifiable revenue loss attributable to cross-over taxpayers. This revenue loss would be in addition to the revenue loss reflected in the above table. These cross-over taxpayers are qualified taxpayers under current law (generally manufacturers) that have energy-generation activities that currently do not qualify for the MIC credit, but will qualify pursuant to this bill. We cannot identify these taxpayers so we cannot forecast the level of revenue loss that may be attributable to them.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1270
As Introduced February 21, 2003

AMENDMENT 1

On page 19, modify line 24 as follows:

The amendments made by ~~the act adding this subdivision~~ Chapter 954 of the Statutes of 1996

AMENDMENT 2

On page 19, modify line 27 as follows:

The amendments made by ~~the act adding this subdivision~~ Chapter 323 of the Statutes of 1998

AMENDMENT 3

On page 31, modify line 7 as follows:

The amendments made by ~~the act adding this subdivision~~ Chapter 954 of the Statutes of 1996

AMENDMENT 4

On page 31, modify line 10 as follows:

The amendments made by ~~the act adding this subdivision~~ Chapter 323 of the Statutes of 1998